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PUBLIC SERVICE COMPANY RATES AND THE FOURTEENTH AMENDMENT.

IN view of the number and importance of the cases in which the protection of the Fourteenth Amendment to the United States Constitution is invoked in the Federal Courts by corporations under the constantly increasing pressure of state regulation of rates, of the doubts still entertained as to the consistency of the Supreme Court in its decisions on this subject,[1] and of the uncertainty as to where the line will ultimately be drawn between permissible and invalid interference of this sort with the rights incident to property, it is thought that an article like the one now proposed may be not unacceptable.

It is the purpose of the article to state as briefly as possible the result of the adjudications of the Federal Courts defining the right of the States to regulate the rates or prices to be charged by so-called public service corporations for their services or commodities, the limitations of that right imposed by the Fourteenth Amendment to the United States Constitution, the nature of the remedies available where the constitutional limitations have been or are about to be violated by the officials of any State, and the special limitations imposed by the Eleventh Amendment to the United States Constitution upon the original jurisdiction in equity of the Circuit Courts of the United States in such cases.

[1] See, for instance, a recently published work by Alfred Russell, Esq., on the Police Powers of the State, chap. vii. Chicago, 1900.

One or two minor and collateral points will also be considered, and reference will be made to certain decisions of state courts which serve to illustrate or explain some of the principles upon which the Federal Courts appear to have proceeded.

We shall also endeavor to indicate some of the unsettled questions involved in the matters enumerated above.

I.

THE RIGHT OF THE STATE TO FIX RATES.

Notwithstanding the hesitation exhibited by some of the justices of the United States Supreme Court in a few of the earlier cases, and the doubt expressed as late as 1891 whether Munn *v.* Illinois,[1] was still law,[2] the actual decisions of that Court are not inconsistent with each other; and they establish an intelligible rule of law with certain plain limits or exceptions.

The general rule is that the several State legislatures have the power to regulate the rates or prices charged for the services rendered or commodities sold by persons or corporations engaged in a business affected with a public interest or use.

This doctrine, though previously asserted by State courts in several jurisdictions, as in Parker *v.* Metropolitan R. R. Co.,[3] was first announced and elaborated by the United States Supreme Court in Munn *v.* Illinois.[4] The subsequent decisions of that Court on this point will be discussed hereafter.

The power of regulation extends to individuals as well as to corporations,[5] and is not dependent upon the existence or non-existence of a charter, grant, or franchise from the Legislature, or upon the reservation of a power of alteration or repeal, but rests upon the police power of the States.[6]

It may be exercised by the people of a State directly through

[1] 94 U. S. 113.

[2] See Chicago, Milwaukee & St. Paul R. R. *v.* Minnesota, 134 U. S. 418, in which three judges dissented on the ground that the majority were overruling Munn *v.* Illinois; and Budd *v.* New York, 143 U. S. 517, where three judges dissented on the ground that the majority were reviving Munn *v.* Illinois.

[3] 109 Mass. 506 (1872).

[4] 94 U. S. 113 (1876).

[5] Munn *v.* Illinois, 94 U. S. 113; Budd *v.* N. Y., 143 U. S. 517; Brass *v.* Stoeser, 153 U. S. 391.

[6] Spring Valley Water Works *v.* Schottler, 110 U. S. 347; Stone *v.* Farmers' Loan & Trust Co., 116 U. S. 307; Wabash, St. L. & P. R. R. *v.* Illinois, 118 U. S. 557, 569; Covington Turnpike Co. *v.* Sanford, 164 U. S. 578; Brass *v.* Stoeser, 153 U. S. 391; Lake Shore & M. S. Ry. *v.* Smith, 173 U. S. 684. But see Russell's Police Powers of the State, p. 108.

an act of its Legislature;[1] or through commissioners, county or municipal authorities, or other officers or agents acting under the provisions of a State constitution or statute.[2]

However exercised, it is always a legislative, and not a judicial function; and, if delegated by a State constitution or Legislature to State officers, the latter, whether designated a "board," "commission," "council," or even "court," are still agents of the State, exercising functions which are in their nature legislative, administrative, or political, and never judicial.[3] The suggestion by Chief Justice Waite in the earlier cases that the duties of such a tribunal are judicial in their nature has been superseded by the doctrine just stated. In Janvrin, Petitioner,[4] however, the Supreme Judicial Court of Massachusetts, in a majority opinion and with some hesitation, sustained a statute giving to actual water-takers within a certain district, part of which was supplied by the respondent water company, the right to apply to that court, or two or more justices thereof, when aggrieved by a rate charged or about to be charged, to determine the reasonableness of the rate. The

[1] The Granger cases, 94 U. S. 113 *et seq.*; Ruggles *v.* Illinois, 108 U. S. 526; Dow *v.* Beidelman, 125 U. S. 680; Chicago & G. T. R. R. *v.* Wellman, 143 U. S. 339; Budd *v.* New York, 143 U. S. 517; Brass *v.* Stoeser, 153 U. S. 391; St. Louis & S. F. R. R. *v.* Gill, 156 U. S. 649; Covington Co. *v.* Sanford, 164 U. S. 578; Smyth *v.* Ames, 169 U. S. 466; 171 U. S. 361; Fitz *v.* McGhee, 172 U. S. 516; Lake Shore & M. S. R. R. *v.* Smith, 173 U. S. 684; Cotting *v.* Kansas City Stock Yards, 79 Fed. Rep. 679.

[2] Spring Valley Water Works *v.* Schottler, 110 U. S. 347; Chicago, M. & St. P. R. R. *v.* Minnesota, 134 U. S. 418; Reagan *v.* Farmers' Loan & Trust Co., 154 U. S. 362; San Diego Land Co. *v.* National City, 174 U. S. 739; Chicago, M. & St. P. R. R. *v.* Tomkins, 176 U. S. 167; Freeport Water Co. *v.* Freeport, 180 U. S. 587; Tilley *v.* Savannah R. R., 5 Fed. Rep. 641; Chicago & N. W. R. R. *v.* Dey, 35 Fed. Rep. 866; Chicago, St. P., M. & O. R. R. *v.* Becker, 35 Fed. Rep. 883; Cleveland Gas Co. *v.* Cleveland, 71 Fed. Rep. 610; Capital City Gas Co. *v.* Des Moines, 72 Fed. Rep. 818 and 829; Milwaukee Ry. Co. *v.* Milwaukee, 87 Fed. Rep. 577; San Diego Land Co. *v.* Jasper, 89 Fed. Rep. 274; San Joaquin Irrig. Co. *v.* Stanislaus County, 90 Fed. Rep. 516; Wilmington & W. R. Co. *v.* Commissioners, 90 Fed. Rep. 33; Northern Pac. R. R. *v.* Keyes, 91 Fed. Rep. 47; Cleveland City Ry. Co. *v.* Cleveland, 94 Fed. Rep. 385; Western Union Tel. Co. *v.* Myatt, 98 Fed. Rep. 335; Kimball *v.* Cedar Rapids, 99 Fed. Rep. 130; Louisville & N. R. R. *v.* M'Chord, 103 Fed. Rep. 216; Pike's Peak Power Co. *v.* Colorado Springs, 105 Fed. Rep. 1; Haverhill Gaslight Co. *v.* Barker, 109 Fed. Rep. 694.

[3] Chicago & G. T. R. R. *v.* Wellman, 143 U. S. 339, 344; Reagan *v.* Farmers' L. & T. Co., 154 U. S. 362, 394, 397; Interstate Com. Com. *v.* Ry. Co., 167 U. S. 479, 499; Interstate Com. Com. *v.* Brimson, 154 U. S. 447, 474, 489; St. Louis & S. F. Ry. Co. *v.* Gill, 156 U. S. 649, 663; Western Union Tel. Co. *v.* Myatt, 98 Fed. Rep. 335; State *v.* Johnson, 61 Kan. 803; Nebraska Tel. Co. *v.* State, 55 Neb. 627; Norwalk St. Ry. Co.'s Appeal, 69 Conn. 576.

[4] 174 Mass. 514, 517.

statute was attacked on the ground that it was an attempt to impose legislative functions upon the judiciary. It was sustained on the ground stated by Mr. Chief Justice Holmes that "it does not undertake merely to make of the Court a commission to determine what rule shall govern people who are not yet in relation to each other, and who may elect to enter or not to enter into relations as they may or may not like the rule which we lay down; it calls on us to fix the extent of actually existing rights. With regard to such rights judicial determinations are not confined to the past. If it legitimately might be left to this Court to decide whether a bill for water furnished was reasonable, and, if not, to cut it down to a reasonable sum, it equally may be left to the Court to enjoin a company from charging more than a reasonable sum in the immediate future." It may safely be said of the statute under consideration in that case that it went to the extreme permissible limit in extending the functions of the judiciary.[1]

A Kansas statute creating a "Court of Visitation" with power both to fix rates and to pass judicially and finally upon them was held unconstitutional by the State court as violating the provision of the State constitution for the separation of the legislative and judicial branches of the State government.[2]

The fixing of rates, being, like any other exercise of the police power, a legislative function, whether done by the people in a State constitution, by their representatives in a State legislature, or by their agents upon subordinate boards, councils, or commissions, is always regarded as the act of the State itself. A rate commission, says Mr. Justice Brewer, in Reagan *v.* Farmers' Loan & Trust Co.,[3] is "merely an administrative board created by the State for carrying into effect the will of the State as expressed by the Legislature."

"The prohibitions of the Fourteenth Amendment," says Mr. Justice Harlan, in *Ex Parte* Virginia,[4] "have reference to actions of the political body denominated a State, by whatever instruments or in whatever modes that action may be taken. A State acts by its Legislature, its executive, or its judicial authorities. It can act in no other way. The constitutional provision, therefore, must mean that no agency of the State or of the officers or agents by

[1] See also Brymer *v.* Butler Water Co., 179 Pa. 231.

[2] State *v.* Johnson, 61 Kans. 803.

[3] 154 U. S. 362, at p. 394.

[4] 100 U. S. 339, 346.

whom its powers are exerted shall deny to any person within its jurisdiction the equal protection of the laws. Whoever, by virtue of public position under a State government, deprives another of property, life, or liberty, without due process of law, or denies, or takes away the equal protection of the laws, violates the constitutional inhibition; and, as he acts in the name and for the State, and is clothed with the State's power, his act is that of the State. This must be so, or the constitutional prohibition has no meaning."

The following are the only kinds of property or business that have been actually held by the United States Supreme Court to be so affected with a public interest as to be subject to the State regulation of rates: namely, railroads, water supply, toll bridges, turnpikes, and grain elevators; but it has also been held in the Circuit Courts that the business of gas, electric light, telegraph, stockyard and street railway companies is affected with a public interest within the rule under consideration, and that the prices charged are, therefore, subject to statutory regulation.[1] In the State Courts ferries, grist mills and telephone companies have also been held to be subject to this power of the legislature.[2]

It would seem as unprofitable to attempt any general definition of what constitutes that "public interest" or "public use" which renders the business and property to which it attaches subject to state regulation of rates and prices as it is to attempt a definition of the "police power" itself. Attempts of the latter kind have been discouraged by the Supreme Court of the United States in several well known passages in its opinions.[3] Certain broad elements of similarity in the subject-matter of the adjudicated cases, suggested by the expression "public service companies" now coming into common use, will in some cases serve as a sufficient criterion.

So far as the actual decisions go the right of regulation of rates has not been carried beyond two classes of cases. In the cases of the first class the right is sustained partly because the business is one of a class that has for a long time been subjected to such regulations and partly because it serves the public necessities or in a high degree the public convenience, and the opportunity to pursue it naturally and generally involves some features of a monopoly. Such are the grain elevator, stockyard, and grist mill cases. In the other class of cases the right of regulation may depend on the

[1] 71 Fed. Rep. 610; 72 ib. 818, 829, 952; 82 ib. 245; 109 ib. 694, and cases *supra*. As to wharfage, see 121 U. S. 444.

[2] 109 Mass. 506; 55 Neb. 627; 86 Me. 102.

[3] 16 Wall. 36, 62; 101 U. S. 814, 818; 115 U. S. 650.

possession by the person or corporation interested of special franchises, such as the power of eminent domain or rights in the public streets; at least this would seem to be a sufficient foundation for legislative regulation of the rates charged by water, gas, electric light, telephone, telegraph, street railway, bridge, turnpike and railroad companies.

It must be confessed, however, that this subject is attended with difficulties, many of which may be insoluble by resort to any general principles, but which may be expected to find a gradual solution by the process of "judicial exclusion and inclusion" applied to the facts of particular cases in the light of existing social and economic conditions. Take, for instance, the business of manufacturing gas or electricity and selling it to distributing companies, unaccompanied by any special franchises. Is it permissible for the State in the exercise of the police power or of any other power to fix the maximum price to be charged for gas and electricity manufactured and sold under such conditions? In connection with this and other doubtful cases it must always be remembered that the circumstances and conditions rendering permissible so strong an exercise of the police power as the regulation of rates and prices are not the same as the circumstances and conditions that might justify some other exercise of that power like the regulation of the times, places, or manner in which the business may be carried on.[1]

II.

THE CONSTITUTIONAL LIMITATION OF THE RIGHT OF THE STATE TO REGULATE RATES.

A. *If the rates fixed by a State are unreasonably low, they are obnoxious to the provisions of the Fourteenth Amendment.*

Having stated the general rule, it remains to state the equally well-settled qualification or limitation,[2] that where a State law or the order of a State commission or other agency fixes rates or prices so low as not to permit the company to earn its operating

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1 Lake Shore M. & S. R. R. *v.* Smith, 173 U. S. 684, 691.

2 Other limitations, namely, that the power of regulating rates cannot be so exercised as to interfere with interstate commerce (see 114 U. S. 196; 116 U. S. 307, 325; 118 U. S. 557; 154 U. S. 206), or in such a manner as to impair vested contract rights (see 94 U. S. 155, 161; 108 U. S. 526, 531, 537; 110 U. S. 347, 353; 116 U. S. 307, 325; 128 U. S. 174, 179; 134 U. S. 418, 454; 156 U. S. 649; 169 U. S. 466, 523; 173 U. S. 684, 687; and Cleveland City Ry. Co. *v.* Cleveland, 94 Fed. Rep. 385), are outside the scope of this article.

expenses properly estimated and a reasonable profit upon the capital actually invested in its plant, such statute or order is the subject of judicial review, and must be declared void, and its enforcement enjoined, as a violation of those provisions of the Fourteenth Amendment to the United States Constitution forbidding any State to deprive any person of his property without due process of law or to deny to any person within its jurisdiction the equal protection of the laws.

This proposition has for many years been the established law of the United States courts, as will appear from the following review of the cases.

DECISIONS OF THE U. S. SUPREME COURT.

Munn *v.* Illinois,[1] which was the first case in which the State regulation of rates was brought before the United States Supreme Court, contains a dictum by Chief Justice Waite to the effect that the reasonableness of such rates is a matter for the sole determination of the State Legislature, and is not the subject of judicial inquiry or review. It is to be observed, however, that in that case the question was not squarely presented whether the rate fixed by the Legislature was so low as to amount to a deprivation of property within the meaning of the Fourteenth Amendment, because that issue was not raised at the trial,[2] and the indictment was not only for charging more than the statutory rate, but also for doing business without procuring the license required by the statute.

In the cases in 94 U. S. 155, 164, 179, 180, 181, the general principles laid down in Munn *v.* Illinois for the business of grain elevators were applied to the transportation by rail of freight. In those cases, also, it was not alleged that the rates were so low as to amount to a deprivation of property without due process of law; but the Chief Justice took occasion to repeat his dictum in Munn *v.* Illinois, above referred to.

In Shields *v.* Ohio,[3] Ruggles *v.* Illinois,[4] Illinois Central R. R. Co. *v.* Illinois,[5] the same general principles were applied to the

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[1] 94 U. S. 113.

[2] The unreasonableness of the rate must be distinctly raised; in civil cases, including actions for penalties, by the pleadings — Chicago & G. T. Ry. Co. *v.* Wellman, 143 U. S. 339; St. Louis & S. F. R. R. Co. *v.* Gill, 156 U. S. 649; Lake Shore & M. S. Ry. Co. *v.* Smith, 173 U. S. 684; Beardsley *v.* Erie R. R., 44 N. Y. Supp. 175; and in a criminal case at the trial — Ruggles *v.* Illinois, 108 U. S. 526; Budd *v.* New York, 143 U. S. 517.

[3] 95 U. S. 319.

[4] 108 U. S. 526.

[5] 108 U. S. 541.

transportation of passengers by rail; but there was no evidence in any of them that the rates were unreasonable.

Up to this time (1883) there had been no qualification of Chief Justice Waite's dictum in Munn *v.* Illinois; and we accordingly find Judge Woods, of the Circuit Court for the Southern District of Georgia, deciding in Tilley *v.* Savannah R. R. Co.,[1] that there could be no judicial review of the reasonableness of rates fixed by a State commission, at least until they had been put in operation.[2]

Then came Spring Valley Water Works *v.* Schottler,[3] in which a State constitution and a statute based thereon requiring certain municipal authorities to fix the rates of water companies was upheld. No rates had in fact been fixed, so that the question of their reasonableness could not and did not arise.[4] In this case, however, Chief Justice Waite took occasion for the first time to qualify his dictum in Munn *v.* Illinois as to the conclusiveness of legislative rates, saying: —

"What may be done if the municipal authorities . . . fix upon a price which is manifestly unreasonable need not now be considered, for that proposition is not presented by this record."

In the Railroad Commission cases,[5] it was held that a bill to enjoin a State railroad commission from fixing maximum rates could not be maintained. In those cases also no rates had been fixed, and therefore the question of their reasonableness was not presented; and the Chief Justice, as may be seen by reference to his opinion,[6] qualifies still further his dictum in Munn *v.* Illinois as to the conclusiveness of State rates.

In Dow *v.* Beidelman,[7] an action by a passenger against the trustees of a railroad for exacting more than the statutory fare was sustained. In this case the reasonableness of the statutory rates was attacked, but it was held that the evidence was not sufficient for the determination of that question. Mr. Justice Gray, speak-

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[1] 5 Fed. Rep. 641 (1881).

[2] See also *Ex parte* Koehler, 23 Fed. Rep. 529.

[3] 110 U. S. 347, 354.

[4] The exercise of the power of regulation being obnoxious to the constitution only in the event that, as applied to some particular case, it is so unreasonable as to amount to a confiscation or deprivation of property, it follows that the courts have no jurisdiction to restrain commissioners from adopting rates. The function of the courts is limited to a power of review after the rates are adopted. Spring Valley Water Works *v.* Schottler, 110 U. S. 347; The R. R. Commission cases, 116 U. S. 307; Georgia R. R. & Banking Co. *v.* Smith, 128 U. S. 174.

[5] 116 U. S. 307, 347, and 352.

[6] p. 335.

[7] 125 U. S. 680, 690, 691.

ing for the Court, intimates that there might be evidence which would require the Court to declare such a schedule of rates void under the Fourteenth Amendment.

We thus have in Spring Valley Water Works *v.* Schottler, the Railroad Commission cases, Dow *v.* Beidelman, the last-named case decided in 1888, intimations by a majority of the Supreme Court, including Chief Justice Waite, that the assertion by the latter in Munn *v.* Illinois of the supreme power of a State legislature over public service company rates was not to be considered as law.

In the mean time, in 1888, Judge Brewer in the Circuit Court held that a bill in equity could be maintained in the Federal courts by a railroad company to restrain the enforcement of rates established by a State commission, which were alleged to be so low as to deprive the company of all (net) compensation for the use of its property.[1]

Passing Georgia R. R. and Banking Co. *v.* Smith,[2] which went off on other points, the next important case was Chicago, M. & St. P. R. R. *v.* Minnesota,[3] in which a judgment of the Supreme Court of Minnesota, ordering the issue of a writ of mandamus to compel the railroad company to comply with the rates fixed by a State commission, was reversed on writ of error, and the case remanded for the taking of testimony as to the reasonableness of the tariff established by the commission.

The case of Minneapolis Eastern R. R. *v.* Minnesota[4] was decided at the same time upon the same ground. In Chicago & G. T. R. R. *v.* Wellman,[5] in which the Court refused to hold a State statute fixing passenger rates unconstitutional, on the ground that the evidence of earnings was too slight and inconclusive to justify any ruling on that subject. Budd *v.* New York[6] and Brass *v.* Stoeser[7] went off on the same ground; namely, the insufficiency of the evidence. In the Budd case, however, Mr. Justice Blatchford, *obiter*, attempts to distinguish rates fixed directly by the Legislature from rates fixed by a commission,[8] — a distinction which was rejected in the Reagan and subsequent cases.

Then came the cases which may be regarded as having finally settled the law on this subject; namely, the Texas Railroad, or

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[1] Chicago & N. W. R. R. *v.* Dey, 35 Fed. Rep. 866; Chicago, St. P., M. & O. R. R. *v.* Becker, 35 Fed. Rep. 883.

[2] 128 U. S. 174. [3] 134 U. S. 418. [4] Ib. 467. [5] 143 U. S. 339.

[6] Ib. 517. [7] 153 U. S. 391. [8] As in 134 U. S. 418.

"Reagan," cases, decided in 1894.[1] These were bills in equity in the Circuit Court against the Railroad Commission and the Attorney-general of the State of Texas to enjoin the enforcement of rates established by the Commission. Upon demurrer the bills were sustained. The opinion was by Mr. Justice Brewer, whose decisions as Circuit Judge in Chicago & N. W. R. R. *v.* Dey,[2] Chicago, St. P., M. & O. R. R. *v.* Becker,[3] Ames *v.* Union Pac. R. R.,[4] had already done much to clarify this branch of constitutional law. St. Louis & S. F. R. R. *v.* Gill[5] went off on the insufficiency of the evidence. Covington Turnpike Co. *v.* Sanford[6] decides that rates which will not permit the maintenance of the efficiency of the plant, the meeting of ordinary expenses of operation, or the payment of any dividend, are void.

The Nebraska case, Smyth *v.* Ames,[7] is probably now the leading case upon the subject. In it the Court confirms the principle of the Reagan cases, and applies it to a bill in equity to restrain the enforcement of a rate fixed by the Legislature, the Attorney-general and other State officers being enjoined from enforcing the statute by legal process of any sort. Fitz *v.* McGhee,[8] in which a bill in equity brought against the Attorney-general of a State to restrain him from enforcing by criminal prosecutions or otherwise a statutory rate, was dismissed on the ground that that officer was not charged by any State law with any special duty with reference to the enforcement of the statute, will be considered in a subsequent part of this article.

In San Diego Land Co. *v.* National City,[9] which was a bill to enjoin the enforcement of a schedule of water rates fixed by a municipality, although the relief was denied upon the facts of the case, the principle of the Reagan cases was elaborately discussed and reaffirmed by the Court.

The latest decision of the United States Supreme Court is Chicago, M. & St. P. R. R. *v.* Tomkins,[10] in which a bill in equity, filed in the Circuit Court of the United States to restrain the enforcement of a schedule of railroad rates adopted by the South Dakota Railroad Commission, was sustained and the judgment of the

[1] Reagan *v.* Farmers' Loan & Trust Co., 154 U. S. 362; Reagan *v.* Mercantile Trust Co., 154 U. S. 413; Reagan *v.* Mercantile Trust Co., 154 U. S. 418; Reagan *v.* Farmers' Loan & Trust Co., 154 U. S. 420.

[2] 35 Fed. Rep. 866. [3] Ib. 883. [4] 64 Fed. Rep. 165.

[5] 156 U. S. 649. [6] 164 U. S. 578.

[7] 64 Fed. Rep. 165 (as Ames *v.* Union Pac. R. R.); 169 U. S. 466; and 171 U. S. 361.

[8] 172 U. S. 516. [9] 174 U. S. 739. [10] 176 U. S. 167.

Circuit Court dismissing the same reversed. The principles announced are the same as in the Reagan and Nebraska cases.

DECISIONS OF THE LOWER FEDERAL COURTS.

It is not deemed necessary to present with great detail the numerous decisions of the inferior Federal courts on the precise proposition now under consideration. The subject has long since passed beyond the elementary stage; and the various Circuit courts of the United States are now mainly occupied with the questions of detail which arise in applying the general rule to peculiar situations.

Some of the Circuit Court cases have been already referred to. Among the others are Cleveland Gas Co. *v.* Cleveland [1] and Capital City Gas Co. *v.* Des Moines.[2] In both these cases demurrers to bills in equity brought by gas companies to restrain the enforcement of alleged unreasonable rates for gas fixed by municipal authorities, acting under the laws of Ohio and Iowa respectively, were overruled. In Capital City Gas Co. *v.* Des Moines,[3] Judge Woolson, while refusing upon the facts shown to grant a temporary injunction, reasserts the general principles laid down by him in deciding the demurrer in the same case.[4]

Cotting *v.* Kansas City Stock Yards [5] was a bill in equity to restrain the Attorney-general of Kansas from beginning proceedings to enforce a State law fixing stockyard charges, and making any violation of the act a misdemeanor; and a motion to dismiss, filed by the Attorney-general and others, was denied.

San Diego Land Co. *v.* Jasper [6] and San Joaquin Irrig. Co. *v.* Stanislaus County [7] were both bills in equity to restrain the enforcement of water rates fixed by county or municipal authorities in California under the laws and constitution of that State; and demurrers to the bills were in both cases overruled.

In Wilmington R. R. *v.* Commissioners,[8] a bill in equity against the Attorney-general of a State and others to prevent the enforcement of rates fixed by a State railroad commission was sustained upon exceptions to the bill.

In Northern Pacific R. R. *v.* Keyes,[9] a final decree was issued on a bill to restrain the enforcement of rates established by a State commission.

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[1] 71 Fed. Rep. 610.
[2] 72 Fed. Rep. 818.
[3] Ib. 829.
[4] Ib. 818.
[5] 79 Fed. Rep. 679.
[6] 89 Fed. Rep. 274.
[7] 90 Fed. Rep. 516.
[8] Ib. 33.
[9] 91 Fed. Rep. 47.

In Cleveland City Ry. Co. *v.* Cleveland,[1] the enforcement of a municipal ordinance regulating street railway fares was enjoined.

In Western Union Tel. Co. *v.* Myatt,[2] a temporary injunction was granted on a bill to restrain the State Solicitor of Kansas from enforcing the rates established by the so-called "Court of Visitation," and the members of the so-called "Court" were also enjoined.[3]

There has been no serious dissent in the Federal courts during the past twenty years from the proposition that State rates, whether imposed by an act of the Legislature or by the order of a State commission or other agents, must be sufficient to cover the expenses of operation properly reckoned and a reasonable profit on the capital invested, or they are obnoxious to the provisions of the Fourteenth Amendment.

DECISIONS OF THE STATE COURTS.

There are also decisions in the State courts to the effect that a State legislature cannot reduce rates below the point of reasonable profit without violating the Fourteenth Amendment; but the State cases are not numerous, as litigation of this character is now generally carried on by means of original bills in the Circuit courts of the United States.[4]

In Janvrin *et al.*, Petitioners,[5] the Court says:—

"The Legislature may fix what the rates shall be, subject only to judicial inquiry whether they are so unreasonably low as to deprive the Company of its property without due compensation. . . . The cases establish the power of the Legislature to fix rates, subject to the qualification that they shall not be unreasonably low."

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[1] 94 Fed. Rep. 385.

[2] 98 Fed. Rep. 335.

[3] See, also, the following cases, in which the jurisdiction of the Court to enjoin the enforcement of unreasonable rates has been upheld: Milwaukee El. Ry., etc., Co. *v.* Milwaukee, 87 Fed. Rep. 577; Kimball *v.* Cedar Rapids, 99 Fed. Rep. 130; Louisville & Nashville R. R. *v.* M'Chord, 103 Fed. Rep. 216; Pike's Peak Power Co. *v.* Colorado Springs, 105 Fed. Rep. 1; Haverhill Gas Light Co. *v.* Barker *et al.*, 109 Fed. Rep. 694. Where a preliminary injunction is granted, the complainant is usually required to file a bond.

[4] See Spring Valley Water Co. *v.* San Francisco, 82 Cal. 286; San Diego Water Co. *v.* San Diego, 118 Cal. 556; Winchester Turnpike Co. *v.* Croxton, 98 Ky. 739; State *v.* Sioux City, etc., R. R., 46 Neb. 682; Janvrin *et al.*, Petitioners, 174 Mass. 514.

[5] 174 Mass 514.

COROLLARIES FROM PROPOSITION II A.

Certain general conclusions must necessarily follow from the power of a State to fix rates, subject to a right of review in the courts to ascertain whether the rates thus fixed are so low as to amount to a deprivation of property.

1. The fixing of rates, whether by a State Legislature or its agents, being a legislative or administrative, and not a judicial act, the courts, in reviewing a State rate, do not undertake to fix the rate itself or to say what rate would not be obnoxious to the Fourteenth Amendment; but simply inquire whether the rate fixed is, under all the circumstances of the case, so low as virtually to deprive the company of its property.

"The Courts do not determine whether one rate is preferable to another or what would be fair and reasonable as between the carriers and the shippers. They do not engage in any mere administrative work." — Mr. Justice Brewer, in Reagan *v.* Farmers' Loan & Trust Co.[1]

"The Court has no power to fix rates. It may not declare what rates would be reasonable, and by its decree establish those rates as the rates to be charged. Its power is exhausted on this point when it has duly passed on the reasonableness of the rates as fixed in the ordinance." — *Per* Cur. in Capital City Gas Light Co. *v.* Des Moines.[2]

2. The fixing of rates, whether by a State legislature or its agents, being the act of the State itself, it matters not that the agents have not properly exercised their powers.

Their act is the act of the State; and if, being authorized (expressly or by construction) to establish only reasonable rates, so that in establishing unreasonable rates they are in a sense acting *ultra vires* of their statutory authority, yet their action in establishing rates which are unreasonable is held to be the action of the State. And, if such action operates as a deprivation of property, it is held to be a deprivation by the State within the meaning of the Fourteenth Amendment.

The same principle holds as to laws of a State alleged to violate the contract clause of the United States Constitution. Thus an ordinance of a city council purporting to have been passed under legislative authority is a State "law," irrespective of its validity. Such ordinances, says the Court, in Penn Mutual Life Ins. Co. *v.*

[1] 154 U. S. 362, 397. See also Osborne *v.* San Diego Water Co., 178 U. S. 22.

[2] 72 Fed. Rep. 818. And see Michigan Tel. Co. *v.* St. Joseph, 121 Mich. 502.

Austin,[1] are "but the exercise by the city of a legislative power which it assumed had been delegated to it by the State, and were therefore in legal intendment the equivalent of laws enacted by the State itself." [2]

3. The fixing of rates, even by a State commission, being in legal contemplation, no matter what the designation or powers of the commission, an administrative, legislative, or political act of the State itself, it further follows that the citizen who has been or will be deprived of his property through the operation of the rates thus fixed does not lose his right to a review by the courts simply because he may have been given full opportunity to present his case to the commissioners before action on their part.

The reasonableness of the rates — that is, the question whether they conflict with the Fourteenth Amendment — is a question of *law*, which the citizen is entitled to litigate in the courts of law.[3] This has been the uniform rule adopted by the United States courts; and the intimation to the contrary in Minneapolis Eastern Ry. Co. *v.* Minnesota,[4] has never been followed; although, if no opportunity to be heard is given before the rates are fixed, that might of itself be an independent and sufficient reason to set them aside.

4. Depreciation — that is to say, the amount in excess of the annual expenditures for repairs, which in a properly managed enterprise must be annually applied or set aside to provide for the final renewal of the several parts of the plant — is a proper charge upon income.

Whether or not it is to be regarded as "operating expense" is rather a question of book-keeping than of law; but, in any event, a proper annual allowance for depreciation must be taken into account in determining the validity of an order fixing rates.[5]

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[1] 168 U. S. 685.

[2] See, also, City Railway Co. *v.* Citizens' Co., 166 U. S. 557; Walla Walla *v.* Walla Walla Water Co., 172 U. S. 1; Illinois Central R. R. *v.* Chicago, 176 U. S. 646; Anoka Water Co. *v.* Anoka, 109 Fed. Rep. 580.

[3] See Chicago, M. & St. P. R. R. *v.* Minnesota, 134 U. S. 418; Reagan *v.* Farmers' L. & T. Co., 154 U. S. 362; San Diego Land Co. *v.* Jasper, 89 Fed. Rep. 274; Louisville & N. R. R. *v.* M'Chord, 103 Fed. Rep. 216, in which, notwithstanding that the complainant had had full opportunity to be heard before the commission, the rates fixed by the latter were declared void by the Court.

[4] 134 U. S. 467, 482.

[5] The Board of Gas and Electric Light Commissioners of Massachusetts has recently advised or prescribed the entering of an allowance for depreciation as a separate item in the annual accounts rendered to it by the companies under its supervision. It is believed that the general practice of such companies throughout the country has heretofore been to enter such items in the operating expense account.

"Compensation," says Judge Brewer in Chicago & N. W. R. R. *v.* Dey,[1] "implies, . . . cost of service," and that "implies . . . keeping the road-bed and the cars and machinery and other appliances in perfect order and repair."

In So. Pacific R. R. *v.* Commissioners,[2] Judge McKenna, in granting a continuance of a temporary injunction against the enforcement of rates established by a State commission, held that, in ascertaining the cost of operating a railroad in reference to the reasonableness of rates, the expenses of operation are not to be strictly limited to the cost of running trains, excluding all betterments, but the cost of reasonable renewals and improvements of road-bed, track, and equipment, must be included.

In Cotting *v.* Kansas City Stock Yards,[3] Judge Thayer says: —

"At the same time, as buildings, pens, pavements, and other similar structures deteriorate in value somewhat from year to year, even where they are repaired in the ordinary way, it is eminently proper, in estimating any profits, to set aside annually out of the gross income a certain sum to cover such depreciation."

And Mr. Justice Brewer, in Reagan *v.* Farmers' Loan & Trust Co.,[4] in stating the opinion of the Court that such expenditures should be considered as proper to be paid from income, says: —

"In the operation of every road there is a constant wearing out of the rails and a constant necessity for replacing old with new. The purchase of these rails may be called permanent improvements or by any other name. But they are what is necessary for keeping the road in a serviceable condition."

"The annual depreciation of the plant," as distinguished from cost of operation, is enumerated by the court in San Diego Land Co. *v.* National City,[5] as one of the matters which "ought to be taken into consideration."

"Ordinary improvement," as distinguished from repairs, are also a charge that "may properly be made against earnings," says Mr. Justice Bradley in an interesting discussion of depreciation in railroad property in Union Pac. R. R. *v.* U. S.[6]

5. Where the complainant is bound by the common or the statute law to the performance of public services and duties, the price at which it may sell its commodities must clearly be high enough to

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[1] 35 Fed. Rep. 866, at p. 879.
[2] 78 Fed. Rep. 236.
[3] 82 Fed. Rep. 839, 850, at p. 855.
[4] 154 U. S. 362, at p. 407.
[5] 174 U. S. 739, 757.
[6] 99 U. S. 402, 421, 422.

enable it properly and satisfactorily to perform these public obligations, as well as to earn a reasonable profit on its plant.

Speaking of the duties of railroad companies as common carriers and of the compensation they are entitled to receive, Judge Brewer says :[1] —

"They may not employ poor engineers, whose wages would be low, but must employ competent engineers, and pay the price needed to obtain them. The same rule obtains as to engines, machinery, road-bed, etc.; and it may be doubted whether even the Legislature, with all its power, is competent to relieve railroad companies whose means of transportation is attended with so much danger from the full performance of this obligation to the public."

6. What sum or value is to be taken as the principal in determining whether the legislative rates will yield an income unreasonably low?

This question presents difficulties, and cannot also be said to have been finally answered by any decision of the Supreme Court. We believe, however, that the answer will be found to be the sum representing the fair cash value at the time the rates are established of all the property then used by the Company in its business. This rule denies to the Company the right to collect returns upon a fictitious or inflated capital, while giving it the benefit of such additions to the plant as may have been contributed by the stockholders from earnings which would otherwise have been paid out in dividends; and, although the question cannot be said to have been finally settled, this rule has been favored by some eminent judges and rejected, we believe, by none.

The outstanding stock and bonds may not represent money actually invested in the plant, or even if fairly representing the original cost, may be largely in excess of the present value of the property. In such cases it is well settled that the thing to be kept in mind is the value of the plant, not the amount of stock and bonds.[2] Conversely we may suppose the case of a corporation as much undercapitalized as most public service corporations are overcapitalized. No such case has, it is true, ever been presented for judicial decision, but if such a situation should arise, the injustice of any method of valuation, or determination of the reasonableness of rates, based upon the amount of the outstanding stock, would at once become apparent. Moreover, such a basis of decision would be inapplicable to companies the stock of which has no par,

[1] Chicago & N. W. R. R. *v.* Dey, 35 Fed. Rep. 866.

[2] 164 U. S. 578, 596–7; 169 U. S. 466, 544; 174 U. S. 739, 757.

and to individuals and partnerships. We conclude that in all cases the sum upon which the company is entitled to a reasonable return is the present value of the property actually used in its business. The judicial references to this subject are as follows:—

In the Kansas City Stock Yard case,[1] the Court says that "the owner is entitled to the benefit of any appreciation in value above original cost resulting from natural causes." It would seem that he should, *a fortiori*, be entitled to any increase in value due to improvements and extensions paid for out of income.[2]

In Northern Pacific R. R. *v.* Keyes,[3] Judge Amidon says:—

"The fundamental question in all cases like these is, Will the rates prescribed by the State pay the expenses of doing the . . . business and leave to the carrier a reasonable compensation upon the fair value of the property which it employs in performing the service?"

The fair value of the property rather than the amount of stock or bonds outstanding is relied upon by the Supreme Court in Smyth *v.* Ames,[4] as the proper basis for determining the reasonableness of a State rate. Mr. Justice Harlan, speaking for the Court, says:—

"We hold . . . that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public."

And in San Diego Co. *v.* National City,[5] Mr. Justice Harlan, speaking for the Court, says:—

"What the company is entitled to . . . is a fair return upon the reasonable value of the property at the time it is being used for the public."[6]

7. The mode of valuation.

Certain difficulties will generally be encountered in attempting to apply to concrete cases the test implied in such expressions as "fair cash value," "fair value," and "reasonable value." To develop all the implications of these and similar expressions as applied to the class of cases with which we are dealing would carry us far beyond the limits set for this article. A few suggestions may, however, not be out of place. Waterworks, including sources of

[1] 82 Fed. Rep. 850.
[2] Brymer *v.* Butler Water Co., 179 Pa. 231.
[3] 91 Fed. Rep. 47, at p. 52.
[4] 169 U. S. 466, at p. 546.
[5] 174 U. S. 739, at p. 757.
[6] In the lower court (74 Fed. Rep. 79) Ross, J., says at p. 83: "It is the actual value of the property at the time the rates are to be fixed that should form the basis upon which to compute just rates."

supply and distribution systems, gas and electric lighting plants, railroads, and other properties affected with a public interest are usually not bought and sold in their entirety sufficiently often or under conditions sufficiently similar to have any "market value" in any useful or significant sense of that expression. In view of the inapplicability of the simple test of market value resort must be had to several lines of evidence, no one of which is by itself conclusive of the ultimate problem, which is, what is the present value of the plant or property considered as a whole for the purposes of its actual use. Judicial discussion of this problem has unfortunately been somewhat meagre. Applying the analogy of cases of eminent domain involving similar properties, it would seem that original cost would in most cases be admissible, though generally not very valuable evidence.[1]

The cost of reproducing the plant item by item, with a proper deduction for depreciation due to use and age, would also seem to be admissible,[2] though likely to be misleading where the assembled plant or any considerable portion of it represents a method of doing the business which by the progress of the arts and sciences has become antiquated or obsolete, or where, by reason of bad judgment in the original selection or assembling of the components of the plant or in its situation, the plant as a whole is ineffective, inadequate, or unduly expensive to run.

Among the best considered rate cases bearing upon the present question is Capital City Gas Co. *v.* Des Moines,[3] in the Circuit Court for the Southern District of Iowa. In his opinion Judge Woolson says: —

"Under the proof presented the plant is in excellent condition and efficiency; and the cost of reproduction appears to be the substantial equivalent of its value. . . . Returning to the attempt to ascertain the cost of present reproduction of plaintiff's gas plant, or rather of a gas plant which shall be equally efficient and capable in supplying gas to the defendant and its citizens, . . . I conclude that suitable and proper real estate could be obtained and such plant erected, mains laid, etc., with same efficiency to meet the demands of the city as that now possessed by plaintiff, for $400,000."

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[1] 100 Mass. 350; 103 ib. 365; 108 ib. 535; 109 ib. 438; 141 ib. 298; 168 ib. 541; 60 N. E. Rep. 977; 76 N. Y. 121; 49 N. J. L. 1; 58 Ill. 380.

[2] 168 Mass. 541; 155 ib. 35; 32 Minn. 224; 135 N. Y. 116; 23 Nev. 154; 49 N J. L. 1; 72 Fed. Rep. 829.

[3] 72 Fed. Rep. 818.

The passage just quoted suggests the necessity for the qualification of the test of reproductive cost already adverted to. For if the existing plant is in any respect antiquated or inefficient as compared with a new plant of modern design and of the same capacity, and shows a greater expense per unit of output or work done, then the cost of procuring such modern plant will fix the maximum sum which a prospective purchaser of the existing plant, though willing to buy, could afford to pay. The company's plant may be worth much or little, but cannot well in any event be worth more than the cost to procure a new plant of equal capacity and modern design.

In computing the cost of a plant it seems proper to include allowances for interest during construction, engineering, bookkeeping, canvassing for subscribers, and all professional and contingent expenses during the period of installation, which together measure the difference in value between two enterprises similar in all respects, except that one is a "going concern" and the other prospective;[1] and from the cost of the new and modern plant to deduct a sum representing the shorter future life of the existing plant due to age and to the extent to which it has been allowed to get out of repair, and a further sum representing the difference in cost of operation or mechanical value between the existing plant and a new plant of modern design. The sum thus obtained would seem to approximate as nearly as possible to the fair value of the existing plant for the purpose of testing the validity of a legislative schedule of rates.

To what extent, if at all, it is proper to add to the value thus obtained a sum to represent the value of the company's franchises, may be a matter of some doubt, especially if any of the franchises were the subject of an out and out sale by the public to the company. It has also been intimated that the company's business and earnings might be taken into account; but it would seem that this is unsound, both for reasons applicable specially to this class of cases and in view of the analogy of the measure of damages in cases of eminent domain.[2] For purposes of taxation, also, a sharp

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[1] 62 Fed. Rep. 853; 60 N. E. Rep. 977; 168 Mass. 541; A. C. (1893) 444.

[2] 82 Fed. Rep. 839, 850; 12 Cush. 605; 3 Allen, 133; 108 Mass. 535; 109 ib. 438; 117 ib. 302; 157 ib. 218; 176 ib. 101; 59 N. E. Rep. 658, 1020; 26 Fed. Rep. 417; 62 N. H. 561; 133 N. Y. 628; 35 Hun 633; 95 Pa. 426; 99 ib. 631; 107 ib. 461; 140 ib. 510; 148 ib. 429; 177 ib. 252; 190 ib. 51; 192 ib. 632; 61 N. J. L. 32; 49 Cal. 139; 32 Minn. 224; 106 Ill. 253; 111 ib. 499; 115 ib. 97; 167 ib. 85; 86 Ill. App. 392; 98 Ga. 92; 91 Tenn. 291; Cooley, Const. Lim., sects. 696, 697.

distinction is made between the value of the property of corporations (which is subject to local taxation) and the value of their franchises, good will, and business.[1] And it is believed that generally it will be found that the only rule which will work substantial justice to the public as well as to the Company is to omit altogether from valuations made for the purpose of determining the validity of legislative rates all items representing or purporting to represent the value of the Company's franchises (except, perhaps, franchises for which the Company has actually paid the public), business, profits, and good will. In any event it may be asserted with confidence that any method of valuation based upon a capitalization of earnings for any period, or upon the selling value of the Company's stock (whether the property is overcapitalized or undercapitalized), is wholly inadmissible.

8. What constitutes a reasonable return?

The rate of compensation to which the company is entitled is a question as yet unsettled, and one which is perhaps incapable of a specific answer applicable to all cases. Mr. Justice Brewer, in his decision in the Dey case,[2] seems to have thought that any net return, however small, was sufficient to meet the requirements of the Fourteenth Amendment; but, as pointed out by Mr. Justice McKenna in the Southern Pacific case,[3] this view was retracted by Judge Brewer in his decision as Circuit Judge in the Union Pacific case,[4] and "has received no judicial sanction since."

It would seem that the just rate of compensation would be that determined by the percentage of net profit expected and commonly obtained in enterprises not affected with a public interest and involving about the same business risk. The tendency has been, however, to seek for a more easily ascertainable and more arbitrary test. In the Kansas City Stock Yard cases,[5] a legislative rate which allowed 5 3-4 per cent profit on the value of the property after all expenses and an allowance for depreciation was held not to be in violation of the Fourteenth Amendment; and Judge Foster, in the first of these cases, suggests that "doubtless the rate fixed by law for interest on money furnishes a test of which the investor

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[1] 12 Mass. 252; 11 Allen 268; 12 ib. 75; 13 ib. 391; 16 Gray 38; 98 Mass. 19, 25; 99 ib. 146; 100 ib. 399, 403; 144 ib. 598; 146 ib. 403, 412; 6 Wall. 611, 632. See, also, 48 Hun 193; 158 N. Y. 162, 168; 144 Pa. St. 365; 67 N. H. 514.

[2] 35 Fed. Rep. 866.

[3] 78 Fed. Rep. 236, at p. 261.

[4] 64 Fed. Rep. 165.

[5] 79 Fed. Rep. 679; s. c. 82 ib. 839, 850.

cannot complain, although in many cases it might be oppressive to the general public."[1]

B. If the rate has been fixed arbitrarily or inconsistently so as to discriminate against the complainant with regard to other persons or corporations similarly situated, it is obnoxious to that part of the Fourteenth Amendment which prohibits the States from denying to any person within their jurisdiction the equal protection of the laws, irrespective of the question whether it is in itself unreasonably low.

For this provision means that the law and its administration must be impartial and not characterized by arbitrary or capricious discrimination between persons.[2] In Wilmington & W. R. Co. *v.* Commissioners,[3] a bill in equity to restrain the Attorney-general of a State from enforcing rates established by a State Railroad Commission was sustained on exceptions, the material allegations of the bill being that the Commissioners' order was inconsistent with prior orders of the same body, and with its action in regard to other railroads in the State in such a way as to amount to an arbitrary discrimination.

It may be added that it is in cases of this sort that a refusal of the State legislature, board, or commission to afford the party affected any opportunity to be heard may be important,[4] as would the fact that the reasons assigned by the Commissioners were wholly irrelevant, or a mere cover for action in reality based upon improper reasons.[5] So a discrimination between classes, as a law compelling a company to transport a certain kind of freight or a certain class of passengers, or to carry on a certain part of its business, at a loss, has been thought obnoxious to the Fourteenth Amendment.[6]

Insistence on a uniformity of rates under similar conditions may give rise to many embarrassments. Suppose that a company can, owing to exceptionally able management in the past or present, sell at a much lower rate than the average rate necessary to

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[1] See, also, Milwaukee El. R. R. & L. Co. *v.* Milwaukee, 87 Fed. Rep. 577; San Diego Water Co. *v.* San Diego, 118 Cal. 556; Brymer *v.* Butler Water Co., 179 Pa. 231.

[2] Yick Wo *v.* Hopkins, 118 U. S. 356; Gulf, etc., R. R. *v.* Ellis, 165 U. S. 150; Lake Shore M. & S. R. R. *v.* Smith, 173 U. S. 684; Trustees Cincinnati Ry. *v.* Guenther, 19 Fed. 395; Jew Ho *v.* Williamson, 103 Fed. Rep. 10.

[3] 90 Fed. Rep. 33.

[4] San Diego Water Co. *v.* San Diego, 118 Cal. 656, 575.

[5] State of Ohio, *ex rel.*, etc., *v.* Cincinnati Gas, etc., Co., 18 Ohio St. 262.

[6] 169 U. S. 466, 541; 173 U. S. 684; 61 Kans. 439; 31 L. R. A. 47.

return a reasonable profit to other companies similarly situated, is it permissible to reduce the rates of such company below this average? This question has never been adjudicated; but it has often been declared that the interests of both parties are to be kept in view, and that the fair value to the community of the service in question is to be regarded as well as the company's right to a reasonable return upon its investment.[1]

N. Matthews, Jr.,
W. G. Thompson.

BOSTON, October, 1901.

[*To be continued.*]

[1] 164 U. S. 578, 596; 169 U. S. 466, 543; 173 U. S. 684, 687; 174 U. S. 739, 753, 757.